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IN THE

Supreme Court of the United States

October Term, 1944 — No. 953

IN THE MATTER

OF

CHILDS COMPANY, DEBTOR

In Proceedings for Reorganization under Chapter X of the Bankruptcy Act — No. 82,868

JOHN F. X. FINN, as Trustee of CHILDS COMPANY
Petitioner

against

BURTON C. MEIGHAN, Jr., as Substituted Trustee under the Last Will and Testament of William T. Wood, Deceased
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT and BRIEF IN SUPPORT OF PETITION

LORENZ, FINN & LORENZ
Attorneys for Petitioner
165 Broadway
New York 6, New York

JOSEPH LORENZ
Of Counsel

307 BAR PRESS, INC., 47 WEST ST., NEW YORK. BO. 9—0157 - 8

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Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

Your petitioner, John F. X. Finn, as Trustee of Childs Company, respectfully prays for a writ of certiorari to the Circuit Court of Appeals for the Second Circuit to review a decree of that Court entered in the above entitled proceeding on January 18, 1945, affirming an Order of the United States District Court, dated September 27, 1944, which granted a petition of the respondent and adjudged that all rights of petitioner and of Childs Company under

an indenture of lease dated July 31, 1922, as modified, covering premises at 1553 Broadway, New York City, had terminated and come to an end (R. 66).

Neither the opinion herein of the United States District Court for the Southern District of New York nor the opinion of the Circuit Court of Appeals for the Second Circuit has yet been reported.

I

Summary and Short Statement of the Matter Involved

Childs Company, the Debtor herein, is engaged in the business of operating a chain of restaurants. It has been a lessee of, and has operated a restaurant upon, the premises at 1553 Broadway, New York City, for more than 40 years. On July 31, 1922, the Debtor entered into a lease with a predecessor of the respondent landlord for a period of twenty-one years from May 1, 1926 to April 30, 1947 covering said premises (R. 7). (The lease was subsequently modified in respects not pertinent here.) The Debtor has a heavy investment in improvements and equipment in the leasehold (R. 22). Said lease contains the following provision (R. 7-8):

> "4. The tenant covenants that * * * if a petition in bankruptcy shall be filed by the tenant or if the tenant shall be adjudged bankrupt or insolvent by any Court, or if a trustee in bankruptcy of the tenant shall be appointed in any suit or proceeding brought by or against the tenant, then and in each and every such case, the term hereby granted shall immediately cease, determine and come to an end, and the landlord may recover and resume possession of the demised premises by any legal means."

On August 26, 1943, the Debtor filed a voluntary petition for its reorganization under Chapter X of the Bankruptcy Act, in the United States District Court for the

Southern District of New York, and on that day John F. X. Finn was appointed Trustee of the Debtor by order of said Court (R. 42). The petition for reorganization stated that the Debtor was unable to pay its debts as they matured (R. 42).

On May 9, 1944, the attorney for the Trustee of the Debtor wrote the landlord stating that the Trustee was desirous of assuming the lease at 1553 Broadway, New York, as modified (R. 40).

On June 23, 1944, the Trustee received a notice from the landlord stating that said lease "has ceased, determined and come to an end by virtue of the bankruptcy proceedings now pending in the United States District Court, Southern District of New York, relating to the Childs Company" (R. 35).

Immediately thereafter, by petition verified June 27, 1944, Burton C. Meighan, Jr., the respondent landlord, brought a petition in the United States District Court, for the Southern District of New York, for an order adjudging that the lease of the Debtor had terminated (R. 6-10). The ground upon which the landlord based his petition was the filing of the petition for reorganization, as above set forth, and the appointment by the Court of petitioner as Trustee of the Debtor, which the landlord claimed was in violation of the forfeiture provision of the lease.

The courts below have held that the filing of the petition for reorganization containing the allegation that the Debtor was unable to meet its debts as they matured, and the appointment of the Trustee of the Debtor, pursuant to said petition, constituted an adjudication that the Debtor was "insolvent", in violation of the above quoted forfeiture provision of the lease, and that the lease had therefore automatically terminated on the day of the Trustee's appointment. The correctness of this determination presents an issue of law which is the sole question in this case.

An order staying the mandate of the Circuit Court of Appeals, pending application for certiorari, was granted by Mr. Justice Jackson on February 9, 1945.

II

Reasons Relied Upon for the Granting of the Writ of Certiorari

1. The decision of the Circuit Court of Appeals for the Second Circuit in the instant case is in direct conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Simmons* v. *National Tool Co.*, 110 Fed. (2d) 850. This conflict between the Circuits involves an important principle affecting corporation reorganizations and should be determined by the Supreme Court.

2. The decision of the Circuit Court of Appeals for the Second Circuit in the present case would seriously impede the administration of corporate reorganizations under Chapter X of the Bankruptcy Act and thwart the purpose of the statute in many instances.

3. The decision by the Circuit Court of Appeals for the Second Circuit violates fundamental and general rules of construction with respect to forfeiture clauses in leases or other contracts, and has given the phrase in question in the lease an unjustifiable construction.

WHEREFORE your petitioner prays that a writ of certiorari be issued under the seal of this Court, directed to the United States Circuit Court of Appeals for the Second Circuit to the end that this cause may be reviewed and determined by this Court; that the decree of the Circuit Court of Appeals for the Second Circuit be reversed; and that petitioner be granted such other and further relief as may be just and proper.

Dated: New York, February 15, 1945.

JOSEPH LORENZ
Counsel for Petitioner

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Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I

The opinions below and the statement of the case are believed sufficiently set forth in the foregoing petition.

II. GROUNDS OF JURISDICTION

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C., Sec. 347) and Section 24 (c) of the Bankruptcy Act.

III. SPECIFICATION OF ERRORS

The Petitioner will urge that the Circuit Court of Appeals for the Second Circuit erred:

1. In holding that the filing by the Debtor of a voluntary petition for reorganization under Chapter X of the Bankruptcy Act in which it was alleged that the Debtor is unable to meet its debts as they matured and the entry of an order by the District Court approving the petition, constituted an adjudication that the Debtor was "insolvent" in violation of the forfeiture clause contained in the lease between the parties.

2. In holding that the term "insolvent" as contained in said lease was to be construed as meaning inability to pay debts as they mature, as distinct from insolvency in the bankruptcy sense.

3. In that the decision of the Circuit Court of Appeals violates fundamental and general rules of construction with respect to forfeiture clauses in leases or other contracts, and has given the phrase in question in the lease an unjustifiable construction.

4. In failing to reverse the order of the District Court decreeing that the lease between the parties was terminated and directing the petitioner and the Debtor to vacate the premises in question.

IV. SUMMARY OF ARGUMENT

The points of argument will follow the reasons relied upon for the Writ of Certiorari, and will be discussed in the order stated in the petition.

V. ARGUMENT

POINT I

The decision of the Circuit Court of Appeals for the Second Circuit in the instant case is in direct conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Simmons* v. *National Tool Co.*, 110 Fed. (2d) 850. This conflict between the Circuits involves an important principle affecting corporate reorganizations and should be determined by the Supreme Court.

On August 26, 1943, the Debtor herein filed its petition in the District Court for the Southern District of New York for corporate reorganization, alleging therein that it was unable to meet its obligations as they matured (R. 42). This allegation was required in order to comply with Section 130 of Chapter X to the effect that:

> "Every petition shall state (1) that the corporation is insolvent *or* unable to meet its debts as they mature." (Italics ours.)

Upon the same day, the District Court entered an order approving the filing of the petition and appointed a trustee of the Debtor (R. 42). The District Court (R. 54) and the Circuit Court of Appeals have decided that the filing of the voluntary petition for reorganization with the allegation by the Debtor that it was unable to meet its debts

as they matured, and the approval of the petition by the District Court, as is required by Chapter X, constituted an adjudication of insolvency within the meaning of the forfeiture clause contained in the lease.

The Court of Appeals in its opinion stated the issue presented as follows (R. 65):

> "The sole issue presented by this appeal is whether the district court was correct in construing the clause 'if the tenant shall be adjudged bankrupt or insolvent by any court' to apply to the order of the bankruptcy court approving the debtor's petition in reorganization and appointing a trustee. The appellant contends that 'insolvent' as used in paragraph 4 of the lease refers to insolvency in the bankruptcy sense, that is, to an excess of liabilities over assets rather than an inability to meet obligations as they mature."

The Court further stated:

> "Since the time-honored meaning of insolvency, in the absence of a statute specifying another meaning, is inability to meet obligations as they mature in ordinary course of business, it is entirely reasonable to suppose that the parties used 'insolvent' in that sense rather than in the limited sense already covered by 'adjudged bankrupt'."

The decision of the Circuit Court of Appeals for the Second Circuit in the instant case is in direct conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Simmons v. National Tool Co.*, 110 Fed. (2d) 850. In that case the National Tool Co. had a license under a patent to use certain grinding machines. The license contained a provision that "in the event of the bankruptcy, *insolvency* or dissolution of the National Tool Co., no title to said machines shall be vested in any receiver or trustee * * *" (italics ours). The National Tool

Co. filed a petition for relief under Section 77B of the Bankruptcy Act in which it alleged that "the Debtor is unable to meet its debts as they mature * * *". The patentee contended that the filing and approval of the petition constituted an adjudication of insolvency of the National Tool Co. which operated as a cancellation or termination of the license. This is precisely the same claim which was made by the landlord in the instant case. The Circuit Court of Appeals for the Sixth Circuit flatly rejected this contention, stating, at page 850:

> "* * * it being the view of the court that the reorganization under Section 77B does not involve 'bankruptcy, insolvency or dissolution' in the sense those terms are used in the license agreement".

An examination of the record in the *Simmons* case discloses that the appellant in that case relied upon the cases in the Second Circuit of *In re Wil-Low Cafeterias Inc.*, 95 Fed. (2d) 306 and *In re Walker*, 93 Fed. (2d) 281, which are the primary cases relied upon by the Circuit Court of Appeals for the Second Circuit in the case at bar. The Sixth Circuit obviously rejected the authority of said cases.

POINT II

The decision of the Circuit Court of Appeals for the Second Circuit in the present case would seriously impede the administration of corporate reorganizations under Chapter X of the Bankruptcy Act and thwart the purpose of the statute in many instances.

Chapter X of the Bankruptcy Act, commonly known as the Chandler Act, was enacted by Congress to provide a more satisfactory method for the reorganization of corporations which found themselves in temporary financial straits. Its purpose was to permit the business of such

corporations to be continued and their assets preserved for creditors and stockholders, rather than have them partially or wholly destroyed by proceedings in bankruptcy or equity receiverships. In innumerable instances, corporate contracts, including leases, constitute assets which, in many cases, are vital to the continuance of the business. Many such corporate contracts contain clauses of the type involved herein. If the decision of the Circuit Court of Appeals for the Second Circuit should in such situations be followed, the very filing and approval of the petition for reorganization would immediately operate to cancel such executory contracts and thus defeat in large part the very purpose of the reorganization proceedings, inasmuch as every voluntary petition for corporate reorganization must allege under Section 130 of the Act that the corporation is "insolvent *or that it is unable to meet its debts as they mature.*" The question presented is novel and has never been passed upon by this Court either with respect to Section 77B or its successor, Chapter X of the Bankruptcy Act. It involves a question of paramount importance in the administration of corporate reorganizations.

POINT III

The decision by the Circuit Court of Appeals for the Second Circuit violates fundamental and general rules of construction with respect to forfeiture clauses in leases or other contracts, and has given the phrase in question an unjustifiable construction.

It is axiomatic that courts of equity abhor a forfeiture, and that in the construction of forfeiture clauses, they have uniformly resolved any doubt against a forfeiture. This attitude is illustrated by the decision of this Court in *Gazlay* v. *Williams, Trustee, etc.*, 210 U. S. 41. In that case the question was whether the bankruptcy of a

tenant terminated a lease providing for its forfeiture "if said lessee shall assign this lease or underlet said premises, or any part thereof, or if said lessee's interest therein shall be sold under execution or other legal process, without the written consent of said lessors." The Supreme Court obviously applied the rule of strict construction, holding that the bankruptcy of the holder of the lease did not terminate it, notwithstanding that bankruptcy works an assignment by operation of law.

The same principle of strict construction has been applied by the Court of Appeals of the State of New York in *Francis* v. *Ferguson*, 246 N. Y. 516. There the Court stated in part:

> "An ordinary covenant against assignment does not bind the executors of the tenant, and is not broken by a transfer of the leased premises by operation of law, Squire *v.* Learned, 196 Mass. 134; 81 N. E. 880; 11 L. R. A. (N. S.) 634, 124 Am. St. Rep. 525, 12 Ann. Cas. 977; Gazlay *v.* Williams, 210 U. S. 41, 28 S. Ct. 687, 52 L. Ed. 950. The covenant may, however, be so drawn as expressly to prohibit such a transfer. To accomplish such a prohibition in case of a devolution to executors, *its language must be 'very special'*. Seers *v.* Hind, 1 Ves. Jr. 294. *Such covenants are construed 'with the utmost jealousy'*. Higgs *v.* Pursell, 66 N. Y. 193, 201." (Italics ours.)

Professor Williston states the rule simply:

> "Therefore construction of a contract which would lead to a forfeiture cannot be favored." (3 Williston on Contracts (1936) Sec. 620, p. 1787.)

Federal courts sitting in bankruptcy are vested with all the powers of courts of equity, and, as this Court has had occasion to state recently, will use such powers to effectuate an equitable result. Thus, in *Pepper* v. *Lytton*, 308 U. S. 295, this Court stated, at pages 304-305:

> "The bankruptcy courts have exercised these equitable powers in passing on a wide range of problems arising out of the administration of bankrupt estates. They have been invoked to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done."

Bearing in mind the acknowledged principle that forfeiture clauses must be strictly construed, it would seem that the decision below in the instant case is unjustifiable.

In the first place, it is clear that under Chapter X itself, inability of a debtor to meet obligations as they mature does not constitute "insolvency". Chapter X, as we have seen, provides that a petition for reorganization shall state that "the debtor is insolvent *or* unable to meet its debts as they mature". Clearly the words "unable to meet its debts as they mature", mean something other than insolvent. Insolvency, moreover, is specifically defined in section 1, subdivision 19 of the Bankruptcy Act, as follows:

> "Whenever the aggregate of his property * * * shall not at a fair valuation be sufficient in amount to pay his debts:".

Obviously, therefore, from the point of view of Chapter X itself, the granting of the petition for reorganization on the ground that the Debtor was unable to meet its debts as they mature, did not constitute an adjudication that "the Debtor was insolvent."

The petitioner recognizes, of course, that the lease was entered into long before Chapter X was enacted. The same definition of insolvency, however,—namely, an excess of liabilities over assets, has been in the Bankruptcy Act since its inception.

We submit, moreover, that the parties intended to use the term "insolvent" as contained in the forfeiture clause in the lease in the bankruptcy sense. For convenience, said clause is repeated here (R. pp. 7-8):

> "4. * * * if a petition in bankruptcy shall be filed by the tenant or if the tenant shall be adjudged bankrupt or *insolvent* by any Court, or if a trustee in bankruptcy of the tenant shall be appointed in any suit or proceeding by or against the tenant, then and in each and every such case, the term hereby granted shall immediately cease, determine and come to an end, * * *." (Italics ours.)

It is submitted that the above clause was intended to cover all types of *bankruptcy* situations and that by the application of the rule of "ejusdem generis" which is palpably called for in the present situation, "insolvent" must be construed in the bankruptcy sense. The court below itself recognized the applicability of the rule that clauses providing for forfeitures must be strictly construed, but was of the opinion that its decision was necessitated in order to give "meaning to every word the parties use," that, therefore, a separate significance had to be given to the word "insolvent". The Court stated in this connection that "such a construction would deprive the words 'or insolvent by any court' of all utility; they would add nothing to the preceding word 'adjudged bankrupt' ". This contention, it would seem, contains a double fallacy. In the first place, by the rule of *ejusdem generis*, it has been frequently held that a number of words may be used to convey a similar meaning. Parties frequently use several words to convey the same idea. Indeed, in the very clause in question as above quoted, the parties stated that upon the happening of any of the grounds of forfeiture, "the term hereby granted shall immediately *cease, determine*, and *come to an end*." Can it be seriously urged that

separate meanings are to be attached to the respective words "cease", "determine" and "come to an end"? In the second place, there is in fact an obvious purpose in the use of the words "or insolvent", in addition to the word "bankrupt". The Federal courts have exclusive jurisdiction over bankruptcies in the administration of the National Bankruptcy Act. On the other hand, if, as has several times occurred in our history, no National Bankruptcy Act is in existence, then the respective State laws covering insolvencies are applicable. The State of New York has such an Insolvency Law. It is contained in sections 50 to 88, inclusive, of the New York Debtor and Creditor Law. This law has not been repealed by the enactment of the National Bankruptcy Act; it is merely suspended in operation. The undoubted purpose of the language in question was to provide that an adjudication of *insolvency* under the State Insolvency Law should constitute a forfeiture if there were no National Bankruptcy Act. Debtors under the National Bankruptcy Act are adjudicated *"bankrupt"*; under the State Insolvency Law, they are adjudicated *"insolvent"*. The State Insolvency Law does not use the word "bankrupt". It would seem clear, therefore, that the purpose of the additional phrase was to cover the contingency of proceedings under the New York Insolvency Law.

It is of fundamental importance, however, to note that the definition of insolvency under the New York Insolvency Law is *not* inability to meet obligations as they mature, but an *insufficiency of assets to meet debts*. Thus section 52 of the Debtor and Creditor Law, defining what a petition for an adjudication of insolvency must contain, states:

> "Sec. 52. *Contents of petition.*—The petition must be in writing; it must be signed by the *insolvent*, * * *; it must set forth, in substance, that *he is unable to pay all his debts in full*; * * * (italics ours).

We urge, therefore, that there was indeed a reason for the insertion of the words "or insolvent" after the words "adjudged bankrupt". That reason was to cover the contingency of an adjudication of insolvency under the State Insolvency Law in the absence of a Federal Bankruptcy Statute, but that the word "insolvent" as used in that State Statute *has precisely the same meaning as it has under the National Bankruptcy Act, namely, an insufficiency of assets to cover liabilities.*

In fact, wholly apart from the definition of insolvency in the sense of more liabilities than assets as used in the New York Insolvency Law, "insolvency" has been defined in the same way in New York in many other instances, both under the Common Law and by statute. Thus in *Kane* v. *Larkin*, 131 N. Y. 300, 307, 308, the Court of Appeals of New York as early as 1892, before the lease in question was made, stated (p. 307) in a case involving a fraudulent conveyance, that:

> "If the grantor remains insolvent after the conveyance and *has sufficient property left to satisfy all his debts*, then the conveyance, whatever his intention cannot be a fraud upon his existing creditors." (Italics ours.)

And again:

> "But the person assailing the deed assumes the burden of showing that it was executed in bad faith and that it left the grantor insolvent and *without ample property to pay his existing debts and liabilities* and so it has been repeatedly held." (Italics ours.)

Similar definitions of insolvency are contained in Section 101 of the Debtor and Creditor Law of the State of New York and in Section 955 of the Penal Law.

It would seem, therefore, that there is no basis for concluding that the parties had any definition of insolvency in mind other than insolvency in the sense of greater liabilities than assets. *To say the very least, there is an ambiguity.* That being the case, since a forfeiture is involved, the ambiguity should be resolved in favor of the tenant.

CONCLUSION

It is respectfully submitted that the petition for certiorari should be granted.

Dated: February 15, 1945.

JOSEPH LORENZ
Counsel for the Petitioner